

Summary Report: **Community Dialogue on Tax Reform** **March 19, 2009 Santa Cruz**

On March 19, 2009, over 120 area leaders and members of the greater Santa Cruz community assembled in the Horticulture Center at Cabrillo College to learn about and discuss tax reform issues. The session was convened by the bipartisan government reform organization *California Forward* (www.caforward.org) and co-hosted by Assemblymember Bill Monning and County Treasurer Fred Keeley. The event's co-sponsors included the Santa Cruz Chamber of Commerce, Action Pajaro Valley and the Community Foundation of Santa Cruz County.

Executive Summary

There was a high level of interest and participation in the session. Participants provided valuable input on several issues via written comments, group discussion and interactive keypad



voting. One area of common ground was an interest in increasing the effectiveness of public education and improving the economy with the intent of providing increased opportunities for all. These goals were the backdrop for a discussion of fiscal reforms.

Participants indicated interest in measures to achieve greater fiscal discipline such as a rainy day reserve and other ways to have government “live within its means.” Several also wanted a multi-year planning cycle, and some specifically asked for a process that would evaluate program

effectiveness. Overall, it appeared that attendees were looking for reforms that would help them increase their ability to trust elected officials enough to give them greater discretion over funding decisions. At the same time, many called for greater dialogue between the public and elected leaders, and a more transparent process.

On the tax front, the greatest agreement was on the concept of giving local communities more control over their tax dollars. The group was asked to consider three specific tax reform concepts. There were distinct ideological differences among the attendees. A majority appeared willing to support modifying commercial property taxes as well as redefining what constitutes a “sale” to generate more revenue via more recognized transactions. A majority also indicated support for introducing a carbon tax as well as extending the sales tax to more services, as long as the services being taxed were “non-essential.” On the other hand, a significant minority opposed these options for various reasons detailed in the report below. Comments from participants indicated that more time would be needed to see if broader common ground could have been discovered on the tax options.

Although the session lasted more than three hours, participants were active until the end, demonstrating the commitment of the attending leaders. Helpful suggestions were provided about how to extend the conversation to a broader cross-section of the community and enhance future meetings.

Meeting Design/Purpose

County Treasurer Fred Keeley welcomed the group and introduced Assemblymember Monning who provided his perspective on the state's fiscal challenges. Following these opening remarks, the meeting was designed to allow for iterative cycles of presentation, small group discussion (supported by table leaders and a participant workbook) and interactive keypad voting. The session built on four earlier revenue reform discussions conducted by *California Forward* with regional leaders in Fresno, Los Angeles, San Diego and San Jose.

Participant input from this Community Dialogue on Tax Reform will be used in a variety of ways. *California Forward* will be sharing key findings with the Commission on the 21st Century Economy as well as use the participants' insights to help shape potential revenue reform proposals of its own. The meeting also was intended to let the co-hosts, co-sponsors and participants see where fellow community members stand on different aspects of tax policy. Because the group assembled was not a scientifically selected sample, significant emphasis will be placed on the qualitative input provided via the workbooks and discussion.

Who Attended

Following the opening remarks, participants shared their demographics via the interactive keypads. Of the 112 voting participants (including two arriving later), the group was balanced for gender (51 percent male/49 percent female), skewed middle-aged (55 to 64 was the most predominant age group) and Caucasian (87 percent). Participants represented a mix of business, education, local government and other community perspectives. 60 percent of participants identified themselves as very or somewhat liberal, 23 percent as middle of the road and 17 percent as somewhat or very conservative.

Again, it is important to note that this audience is not expected to be representative of the greater Santa Cruz area and the findings should not be treated as a scientific survey. For the qualitative analysis, workbooks were turned in by fully 95 of the participants, an extraordinarily high percentage. A preliminary review of that input has been made for this summary report. Additional analysis of the written input will be incorporated into the *California Forward's* report to the Commission on the 21st Century Economy.

The Future We Want for California

James Mayer, Executive Director of *California Forward*, led off the discussion portion of the evening with an overview of a possible vision for California, distilled from multiple past visioning efforts. *California Forward's* experience in prior meetings is that acknowledging some shared goals helps create a constructive context for revenue reform (i.e., what are our taxes paying for?). Participants weighed in on how important each of ten factors was in their vision for California's future. On a scale of 1 to 10, with 10 being the highest level of support,

“effective and equitable education systems” stood out as a universally shared priority, followed by “strong economies and high quality jobs.”

<u>Avg. /Diversity</u>	<u>How Important to California’s Future (scale of 1 to 10)</u>
8.8/18	Effective and equitable education systems
8.2/18	Strong economies and high quality jobs
7.8/20	Good health outcomes
7.8/22	Clean energy and environment
7.8/19	Safe communities
7.6/12	Ongoing investment in infrastructure
7.6/30	More public involvement in public decisions
7.2/27	More efficient public services
7.0/29	Region-level planning and governmental cooperation
6.9/25	Efficient transportation and housing

Some of the ten factors people were asked to consider spoke to *how* these goals might be achieved – e.g. more public involvement in public decisions, more efficient public services, and region-level planning and governmental cooperation. These three had a slightly higher “diversity” score, meaning there was somewhat less congruence on those items.

In the small group discussion and via written comments in the workbooks, participants shared a wide range of additional thoughts about the future they want for California. The most prevalent responses addressed these issues:

- Social justice, equity and ways to provide greater opportunity for more Californians
- More local control in business, community and agriculture
- Ensuring that health care is accessible and affordable
- Creating an environment of innovation
- Amplifications on “clean energy and environment,” e.g. greater environmental stewardship, watershed management and alternative energy
- Various aspects of prison reform

The attendees also considered obstacles to this broad vision. In addition to obstacles suggested by *California Forward* (e.g., chronic fiscal problems, short-term focus, unresponsive bureaucracies, lack of public trust), participants added a variety of perspectives on the factors holding California back from its best future. The most frequently cited obstacles included:

- Partisanship, polarization and extreme self-interest: “Elected officials should work for the state and not a party.”
- Problems with the initiative process: “Initiatives have boxed us in.”
- The 2/3 vote requirement for state budgets .
- Difficulty educating and engaging the public: “We need to take personal responsibility for the functioning of our democracy.”

Values to Guide Spending/Fiscal Reform

The conversation shifted from vision and obstacles to a sharper focus on fiscal issues and the spending side of the budget as a prelude to tax reform. Meeting participants were invited to share open-ended suggestions about their “goals for fiscal reform” and there was an extremely high level of responses. Several interrelated themes emerged:

- Multi-year budgeting – “Get government out of reactive crisis mode.”
- Pay-as-you-go approach – “Live within our means as each of us must” and reduced borrowing.
- Evaluating programs based on objectives and effectiveness.
- A reserve/rainy day fund – “Save in good times to cover the bad.”
- Increased local control of funds.
- Streamline and simplify state operations (with some calling specifically for a downsized government).
- Increased public input/transparency.

On the topic of whether there should be a 2/3 vote of the Legislature to pass the state budget, several attendees volunteered that the threshold should be lowered to 55 percent or a majority vote. A few shared the exact opposite sentiment: “Keep the 2/3.” And some saw a sequential approach: “No change on 2/3 until redistricting and changed term limits.”

In his opening remarks, Assemblymember Monning referred to competing values being part of the challenge in state budget negotiations. James Mayer of *California Forward* shared with the group the extensive process undertaken to develop the bipartisan organization’s common ground on budget process reforms. As a part of that, there remain questions about the balance between the extent to which funding sources should be identified for each public program and the level of discretion given to policymakers. Participants were asked to consider how they would balance these two perspectives. They also voted on their overall level of agreement with each (on a scale of 1 to 10, with 10 as the highest level of agreement):

Avg./Diversity

- | | |
|---------------|---|
| <u>7.1/31</u> | A. No new state programs or tax cuts should be enacted unless they have a defined funding source. |
| <u>6.4/28</u> | B. The Governor and Legislature should be responsible for figuring out how to balance the budget. |

When these two statements were placed at each end of a continuum, some participants felt it was a false dichotomy. In the workbooks, there was a wide range of responses along the continuum. Those who preferred giving lawmakers more flexibility commented that statement A “is too inflexible to adjust to changing needs.” On the other hand, talking about elected leaders, others said about statement B: “They can’t be trusted to do this... they’ve been too irresponsible.”

It appeared that most of the audience understood that the statements presented were not meant to force a choice but rather stimulate thoughts about how to integrate the best parts of both

concepts: “The choices are not mutually exclusive...we need more public process, but ultimately it is the elected leaders’ job.” On the continuum, the workbook responses indicated some skew to the statement about requiring a defined funding source. It seemed that those responses reflected some frustration with the system the way it is now. If some of the budget reforms suggested above were in place, it appeared that people’s ability to trust elected leaders would improve.

The group also was asked to consider another value question tied to the public’s role in determining state priorities. People were asked to consider the relative roles of the public and policymakers in setting priorities for state spending if California were to adopt a results-based budgeting approach (one of *California Forward’s* budget reform proposals). Again, there were responses all along the continuum. Those who favored maximizing the role of the public spoke to concerns that elected officials were often not able to represent the public’s interests: “Few moderates get elected.” Those who indicated a preference for policymakers taking the lead explained that it was what they were “hired” to do. The vast majority of responses were in the middle of the spectrum and asked for better communication/collaboration: “More open dialogue between the public and elected leaders” and “meaningful engagement of the public.”

Values to Guide Tax Reform

Fred Keeley presented an overview of the work of the Commission on the 21st Century Economy (of which he is a member). As he provided background on the state’s current tax system and some of its challenges, many attendees shared their thoughts about their goals for tax reform via open-ended comments in the workbook. The most prevalent suggestions were:

- Taxing internet sales – to capture those revenues as well as to “level the playing field for bricks and mortar retailers.”
- Use tax policy to encourage/discourage different behaviors: taxing gas, tobacco, soft drinks, etc: “We can use tax policy to improve our society.”
- Increase local control of revenues.
- Pursue enforcement, close loopholes; possibly capture income from the underground economy.
- Don’t increase the burden on businesses, especially in a bad economy.
- Resource depletion taxes: oil severance, timber harvest, mining.
- Simplify the tax code.
- Specific tax scenarios – such as increasing property taxes and reducing the sales tax.

In *California Forward’s* prior regional meetings about revenue reform, three key values discussions emerged. The Santa Cruz participants weighed in on these via their workbooks.

Progressive versus Flat

The majority of Santa Cruz attendees were strongly in favor of a progressive tax system. Within that, several suggested removing/reducing deductions which they believed were undermining a progressive structure (although a few specifically requested keeping the credit for nonprofit donations).

A significant minority, close to a quarter of the responses, appeared equally enthusiastic about the flat tax: “People will pay more attention” and “everyone needs to be involved and contribute.” Some suggested various floors or thresholds that would combine the value of everyone participating with a progressive structure on top of that. A few wanted to encourage saving and were interested in greater taxes on consumption than income: “Don’t punish people who save.”

Link between Source and Use

Unlike the prior topic where most people had clear points of view on either “end” of the discussion, responses fell pretty evenly across the spectrum for this question. Those who favored a tighter link between source and use were concerned that the “temptations for elected politicians are too great” without this type of control. On the other hand, some believed that “mandated links hamstring lawmakers.” Some commented that the principle of a link between source and use sounds good in theory but would be hard to implement for policy areas such as K-12 education or higher education.

State versus Local Control of Revenues

The predominant perspective was to increase local control of revenues: “Local government should have all funds associated with the services they are providing.” “Prop 218 is overly rigid. Local government needs more flexibility.” Several wanted to ensure that local decisions include all residents and a few wanted a system that tangibly rewards community engagement in local decision-making. It appeared that some of the enthusiasm for local control was related to disappointment with state performance: “If the state were performing better, I’d still want them to have a role to minimize inequities.” A representative suggestion: “Equity with state baseline funding, then local control after that.”

Feedback on Specific Revenue Options

Fred Keeley described three potential reform options that have been part of the discussions at the hearings of the Commission on the 21st Century Economy. These options were not selected as recommendations of *California Forward* or the meeting’s co-sponsors but rather as a way to have participants weigh in on choices that cover a range of tax policy issues. The options were:

- Extend the sales tax to more services, based on the premise that services are growing more quickly than retail goods.
- Introduce a carbon tax, based on the concept of a tax that could help environmental goals while raising revenue.
- Make changes to commercial property taxes, potentially to capture more income and/or to create greater equity between new and longstanding businesses.

Attendees were invited to consider each of these as either a way to raise new revenue or to think about them as “revenue neutral” (structured in such a way that the total tax burden does not increase). They also were asked to think about “conditions” they might place on each option that could increase their willingness to support it.

Following group discussion, participants rated each option on a scale of 1 to 10. They were then offered two “conditions” for each option (based on conditions that surfaced in prior discussions around the state). Many participants also shared thoughts about the options via comments in their workbooks.

Currently Discussed Tax Reform Options (listed in order of presentation, with two conditions for each)	N Count	Average rating (10-point scale)	Lowest levels of support (1, 2, 3)	Mostly neutral (4, 5, 6, 7)	Highest levels of support (8, 9, 10)
Expand the sales tax to more services	100	5.8	25%	39%	24%
• Only on non-essential services	94	6.6	22%	24%	53%
• Tax services tied to retail goods and entertainment; pays for dropping overall sales tax rate ½ cent	95	4.5	49%	31%	20%
Introduce a carbon tax	103	6.4	26%	25%	50%
• Dedicate the proceeds to environmental purpose	91	5.9	34%	23%	43%
• Add a tax credit for low-income Californians	91	5.1	40%	27%	33%
Change tax on commercial properties	100	6.9	19%	27%	54%
• Redefine sale to capture more transactions	86	6.8	24%	17%	59%
• If assess commercial property at full market value, drop the rate	89	4.9	39%	33%	28%

No one of these tax options achieved a high overall rating from the whole group. There was a high level of “diversity” for each, with a spread of responses all along the 10-point scale. Two of the general tax options and two of the conditions received an 8, 9, or 10 from over 50 percent of the participants: modifying the commercial property tax, redefining what a “sale” is for commercial properties, introducing a carbon tax and extending the sales tax to non-essential services. Yet it should be noted that a significant minority were clearly opposed to all of these.

Extend the Sales Tax to More Services

Many of those favoring this option shared their reasoning, such as “aligns with growth,” “helps grow the pie,” “reliable source.” The greatest common ground was on the concept of excluding “essential services” which increased participants’ support for this option. People volunteered different suggestions for what would be “essential” services: health care/medical services, day care, repairs, veterinary services. Some tried to help define luxury services to include in the tax, such as consulting and financial services used by the wealthy. Others were concerned that taxing professional services would discourage employment. Several comments were made to avoid a business-to-business application of this tax because it’s “double taxation.”



The potential condition of broadening the sales tax and reducing the rate received the lowest rating of all of the tax options considered. Those who favored the overall premise of taxing more services indicated that they were interested in raising additional revenue for “essential services.” The potential ½ cent rate drop (if services tied to retail goods and entertainment were taxed) was not seen as a “significant” enough offset to those who were concerned with the negative impacts of the tax.

Introduce a Carbon Tax

Many participants favored this approach, consistent with the broad principle volunteered by many to use tax policy to achieve social goals such as reducing CO₂ emissions. Some wanted the tax to include all fossil fuels; others, just gas. Several suggested specific uses for the revenue, such as transportation, infrastructure and the development of alternate energy sources. Alternately, some indicated that the funds should go into the General Fund – consistent

with the vote results where designating a specific environmental purpose was rated a little lower than the general premise of a carbon tax without that condition.

It is important to note that there were two distinct voices in the detractors. Some were concerned that a state-levied carbon tax would put California at a disadvantage versus other states and would “impact the cost of doing business.” Others were skeptical about the extent to which climate change is a man-made phenomenon: “This tax could be levied on a lie.”

Finally, the potential condition that a carbon-tax could have an offsetting credit for low income Californians received less support than the original option. For some, this was due to their interest in seeing this tax raise additional revenue, or have an offset in a different part of the tax structure (e.g., lower sales taxes). A few also shared concerns about the mechanism of a tax credit being “too complicated” and that it “will go unclaimed.”

Modify Non-Residential Property Tax

Participant feedback on this option covered a wide range of issues, suggesting that a longer conversation could unpack the interrelated topics. Consistent with the vote results, several comments indicated support of this general direction, especially if funds were controlled and used locally. Some had concerns about the impacts on business: “I would consider it when commercial property owners are doing better” and “Can we exclude small businesses under a certain amount?”

More than the other options, participants asked for information to help understand the points in the workbook. Some of the questions and comments related to Proposition 13. A few volunteered: “Leave Prop 13 alone.” A few more suggested “Consider repeal of Prop 13” and some asked to “Put residential properties on the table too.”

Fred Keeley introduced the concept of redefining what constitutes a “sale” for commercial properties. Responding comments indicated an interest in this approach: “Most large industrial properties don’t change hands” and “There should be periodic reassessment of large property owners. The vote on this concept received the highest level of people rating it an 8, 9 or 10 among all of the tax options considered (59 percent).

Next Steps

On the back of the participant workbook, attendees were invited to offer suggestions for getting others engaged in this discussion, name other topics they’d like to learn more about and identify other solutions they’d like *California Forward* to consider. Despite the late hour, several shared input. There appeared to be a sense of wanting to continue and expand the evening’s conversation. Representative comments:

- Reach out to universities, high schools, civics classes for greater involvement of young people; “You can’t design the future unless you listen to the future.”
- More public education/more meetings; study committees.
- Keep the information simple.
- Involve more low and middle-income folks.
- Show people ways they can get involved.
- Ask people to make tougher choices.
- Frame the issue to include those who want to cut taxes and shrink government.

These were some of the topics/solutions participants asked to hear more about:

- Effectiveness of services: what we spend, what we get, how we compare to other states.
- More information about revenue sources and state/local spending.
- How taxes affect different income groups.
- Downsizing government.
- Corporate tax rates.
- Bonds.
- Can the state generate income? Open up other kinds of funding sources.

Meeting Evaluation

Overall, participants indicated that they found the meeting information helpful, especially the information about budget reform. The speakers, interactive keypads and PowerPoint presentation were seen by most as effective. Most participants found that the information was “just about right” in terms of not being too complicated or too simplified.

Constructive suggestions were made, such as not trying to have such an ambitious agenda and to allow for more time for participant dialogue in future meetings. *California Forward* is deeply grateful to *all* of the participants and welcomes additional suggestions. Please send them to *California Forward*’s Coalitions Director Dennis Quirin at DQuirin@caforward.org.

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